Report to the Wisconsin Joint Legislative Council

Strategic Outlook for the Wisconsin Economy 2001
Wells Fargo Economics

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The current economic slowdown has everyone's attention, but what does the longer run hold for Wisconsin and its place in the national and international economy? Can the state of Wisconsin adopt a strategy that can be implemented in a concrete tactical plan that will significantly improve it long-term economic welfare? The short answer is yes. Fortunately, the state does not need to reinvent itself because it has already done an admirable job. In order for the legislature to improve the state's economy, they need a concrete plan that points out specific sectors and actions that need to be achieved.

Here is the overall plan. Accentuate the state's winning sectors and mitigate its losing sectors. Does this sound too simple? Don't worry. The complex tactical details will certainly make up for any imagined lack of sophistication in the strategy. And, one of the legislature's task will be making laws that balance benefits and risks to strengthen key industries. Another job will be pushing companies to locate activities in Wisconsin in industries with continuing consolidation.

Given a clear strategy, it is easy to move to the details of the tactics. The following list identifies sectors either as outperforming or underperforming in the last decade in Wisconsin. The report bases these sectors on three important criteria; significant size in terms of economic impact, clearly over represented or under represented at the state level, and clearly growing faster or slower than the national sector. Some sectors that are important and clearly under represented in the state can not be changed. Unfortunately, the state of Wisconsin has not discovered large deposit of gold and oil. And, a strategic plan to make that happen probably would not be of much use.

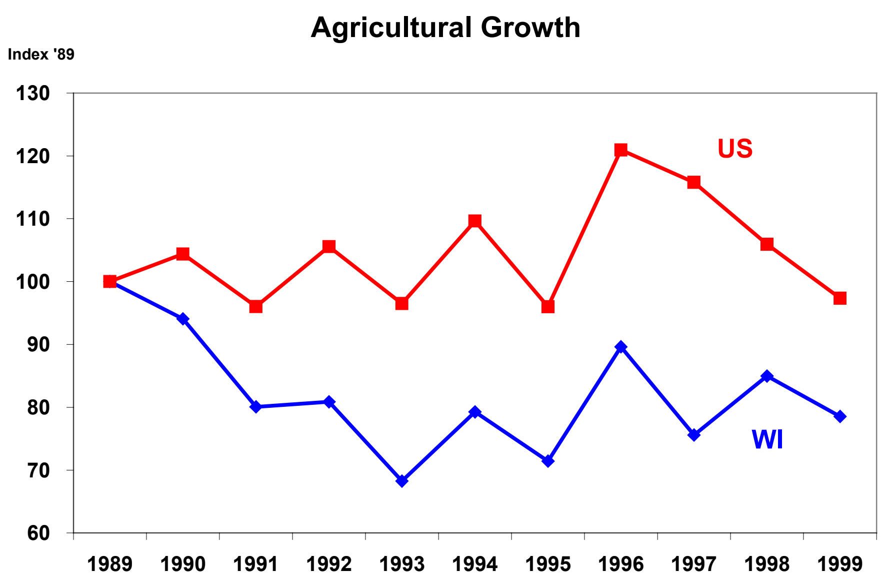
This list follows the basic standard industry classification.

Agriculture continues to be an important driver of out-state communities and rural regions. Wisconsin has almost twice as much agricultural economic activity as compared to the national average. Additionally, it feeds into an important value-added chain of manufacturing and marketing activity in the food and beverage sector. Unfortunately for Wisconsin and farmers nationally, revenues for farming remain flat as intense competition nationally and internationally as left the market in an almost constant oversupply situation. Wisconsin's farm sector has an outsized reliance on dairy farming relative to other farming states. Currently, milk and dairy prices have rebounded nicely from the unprofitable and unsustainable lows of last year. The price recovery rests in part on the reductions in states like Wisconsin and Minnesota which have seen smaller operations exiting the market in significant numbers.

Why are states like California, New Mexico and Idaho taking the lead in dairy growth? Their growth is based on a unromantic economic concept called "increasing returns to scale". Basically, certain fixed costs of the operation (facilities and management) can be spread out over additional cows which decreases the average cost per hundredweight. To say the least, increasing operation size raises contentious issues such as environmental concerns, social concerns and family versus corporate orientation. Some specialists advocate seasonal grazing which moves operations in the opposite direction of capital intensive large-scale operations. These advocates can make the case for this type of practice in some circumstances, but the bulk of milk production has moved to and will move to large-scale operations.

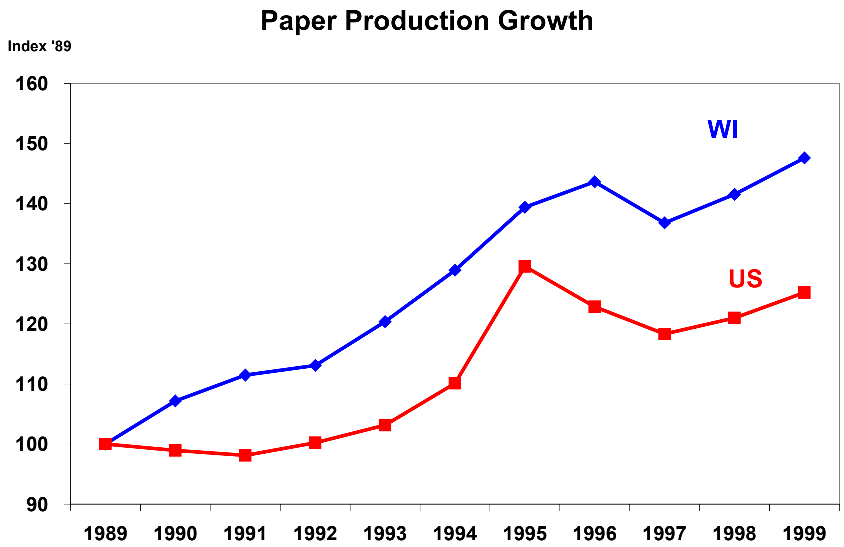
So what should the state of Wisconsin do? Should it advocate large versus small? That type of policy decision rests outside what economics has the right to say. However, economics would recommend that the state make sure that it doesn't preclude large-scale operations where they might profitably and beneficially exist. Environmental requirements and concerns should be clearly defined so that dairy operators who can meet those requirements can move ahead with the minimum of necessary paperwork. The large scale feeding operations in dairy, poultry, cattle and swine will meet the requirements or they won't even start.

What the state needs to avoid is a poorly defined situation that allows constant legal challenges in any number of governmental permitting agencies. The lack of one permit can stop the process without regard to the substance of the other permitting processes. This uncertain situation currently favors opponents of large scale operations, but it is poor framework for economic development. This emphasis on strengthening the standards based permitting process applies to all aspects of agricultural and every facet of Wisconsin's economic environment.



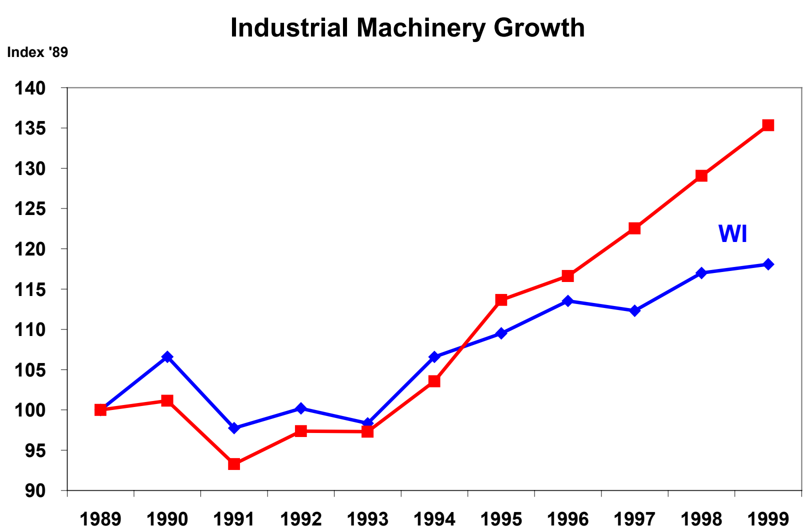
Lumber and wood production feed into the **furniture and fixtures** and the **paper** and **printing** sectors. This represents a situation where Wisconsin's comparative advantage (large forest tracts) led to a competitive advantage (expertise in manufacturing and design). All of these sectors have outsized importance in the Wisconsin economy. For example, Wisconsin has twice the standard activity in lumber and wood, furniture and fixtures as compared to the national economy. It has almost five times the national standard in paper products contributing more than $5 billion dollars to the states gross state product (more that 2.5 percent). As importantly, it has been outgrowing the national economy in all of these categories especially in the furniture and fixtures sector. In total, these sectors contribute approximately 6 percent of the state's gross state product (GSP).

These sectors have not been immune to the pressures of globalization. The NAFTA agreement has solidified Canada's role as the US's and Wisconsin's number one trading partner. However, it has also opened the gate to difficult competition in the key forest products industry. Price competition has made expansion and strong profits in this sector very difficult to achieve. On top of the international pressure, changes in how wood products are manufactured has started to impact the furniture sector. More and more wood composites and laminates are finding their way into furniture and fixtures. This will diminish the linkage between the areas of primary wood production and subsequent manufacturing. However, it also creates an opportunity research and development focused on delivering the new products that constructors and retailer buyers are looking for. The state of Wisconsin has a long history of funding research into wood products research. This represents a natural extension of that support which will keep these keep employment sectors strong into the foreseeable future.



Fabricated metals and **industrial machinery** represent the heart of Wisconsin manufacturing with more than $12 billion in production (approximately 7 percent of GSP). They both have 2.5 times the economic activity compared to the national average. These sectors have grown up based on export activity and strong linkages to the Chicago manufacturing complex. Primary metals and fabricated metals have outgrown the national sectors over the last decade by more than 10 percent, but industrial machinery has lost ground when compared to the national growth.

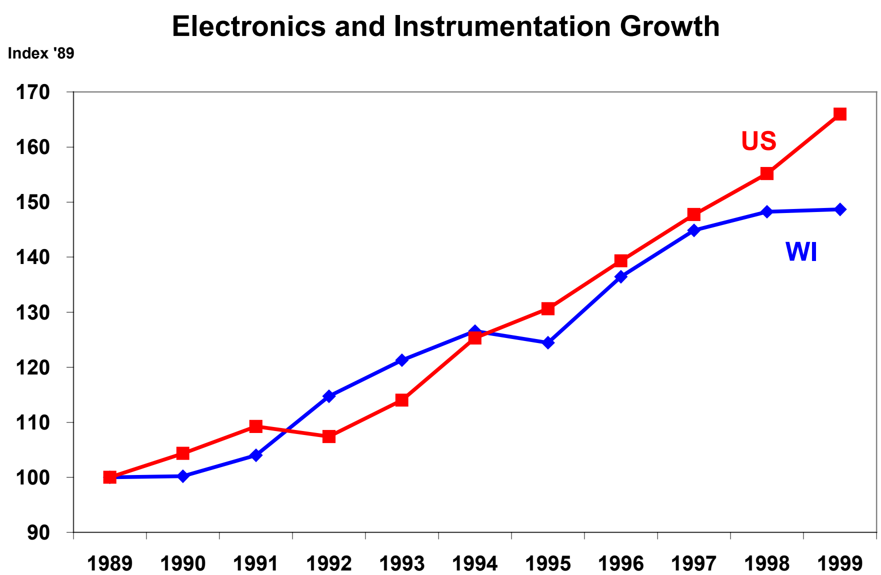
These sectors depend on strong infrastructure and access to highly skilled labor pools. Wisconsin has started to feel the constraints of a labor pool that is not expanding as fast as some other competitive states. While smaller companies can manage to start up and operate in areas with smaller available labor pools. Larger operations and factories need just the opposite. This lack of large available labor pools has a major policy implication. This points to focusing on smaller operations that can fit the demographic profile of the majority of Wisconsin communities.



Electronic equipment and instrumentation have approximately 30 percent more manufacturing activity in Wisconsin as compared to the national average. This category alone represents 3.4 percent of the GSP with more than $6 billion in activity in 2000. However, Wisconsin has seen its electronics complex grow at a slower rate than the national market. Over the last decade, the national electronics complex has outgrown Wisconsin by approximately 11 percent. This differential does not represent a huge shift numerically, but it does point to an industry losing ground in one of the most important economic activities.

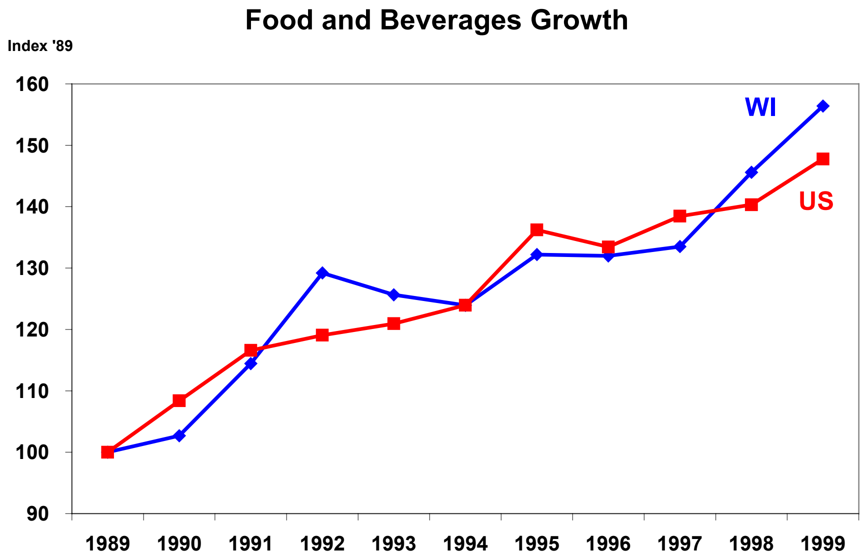
This trend points to an erosion in Wisconsin's place in the electronics manufacturing industry. This industry is also problematic in how the state can address it competitiveness. This industry has received a lot of focus from many states and countries eager to secure their place in the future economy. Providing specific incentives can be a risky and unrewarding strategy. New microchip factories can cost billions of dollars to start, and the companies that locate these factories want large tax incentives and large pools of potential employees with particular skills. Even winning the race to receive the large factories can be a mixed blessing with increased infrastructure needs and uncertain tax revenues in a competitive industry.

A more diversified and appealing strategy would be to focus on smaller specialty electronic manufacturing. The Wisconsin University system has a history of focusing on applied research relating to niche market needs. The emphasis should be on supplying control and instrumentation electronic for the manufacturing in sector where Wisconsin already has strength. Many of sectors already mentioned are ideal candidates for emphasis and partnerships. The need for increasing productivity and supporting the electronics complex make a natural fit for targeted research and development at the university level.

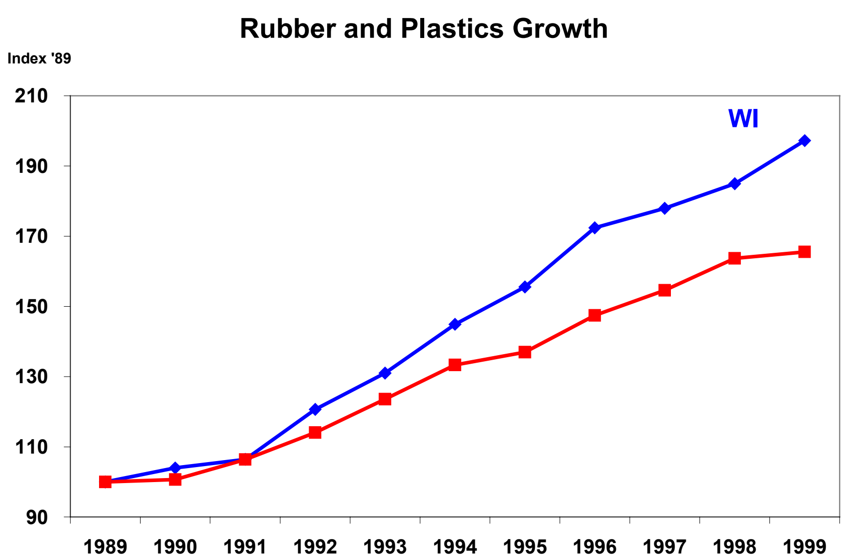


Food and beverage manufacturer is a natural extension of the strong agricultural production in the state. The state has 2.2 times the national average activity in these sectors accounting for more than $5 billion in activity. The sector has outgrown the national sector over the last decade showing a solid future. And, the future seems even brighter with fast growing trade with Mexico which has a long way to go in terms of food consumption.

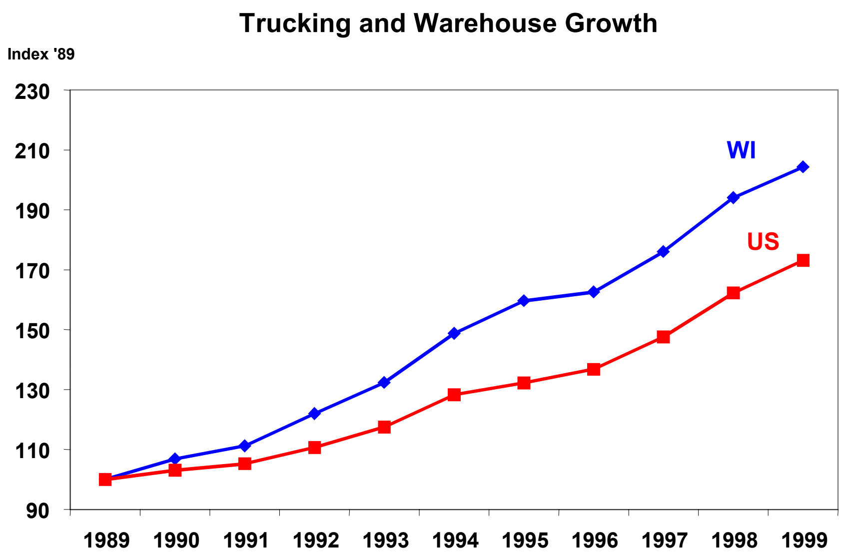
However, key segments like dairy processing will be threatened if the basic producers become noncompetitive. Just as in basic agriculture, increasing returns to scale have forced industry consolidation. Additionally, massive consolidation in food retailing brought on by the Wal-marts and Krogers of the world have also forced consolidation in the food processing world. The incredible purchasing power that mega-retailers have pushes the food processing companies to grow to maintain they bargaining power. Whether the state of Wisconsin can curtail this trend is unlikely, but it can foster the specialized workforce that can provide the high-tech and high quality demanded in today's consumer markets. This ability to generate the specialty ingredients and packaging will almost certainly guarantee increasing production in this sector.



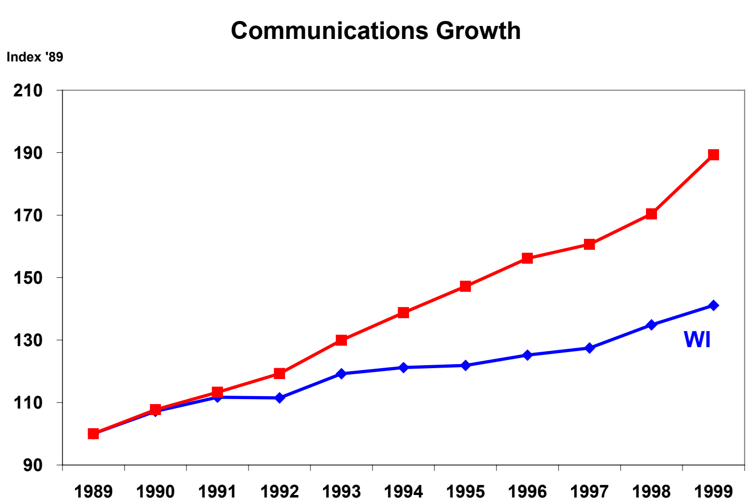
Rubber and plastics manufacturing have a long and successful place in the Wisconsin economy. Wisconsin has twice the manufacturing activity as compared to the national average which contributes more than $2 billion to the GSP. It has also outgrown the national pace over the last decade by approximately 20 percent. This industry serves as a vital supplier to the other manufacturing sectors already mentioned. For example, industrial machinery and food and beverage manufacturing all need large amount of rubber components and plastic packaging. The input-output tables from the Bureau of Economic Analysis trace a clear linkage between these sectors. This sector can be supported by keeping the primary users of its outputs strong.



Trucking and warehousing serve as natural extensions of the strong manufacturing base in the state. Wisconsin firms are also well positioned to service both the Chicago and Minneapolis areas. Many firms have taken advantage of Wisconsin's proximity and lower land costs to service these two large metropolitan areas. Wisconsin has 70 percent more activity than the US average which contributes more than $3.6 billion to the GSP. And, the state has outgrown the US by 20 percent over the last decade. The state can continue to take advantage of its industrial base and location to promote growth in this sector. It can also make sure that regulatory and tax arrangement make it a state friendly to the expansion of trucking and warehouse operations.

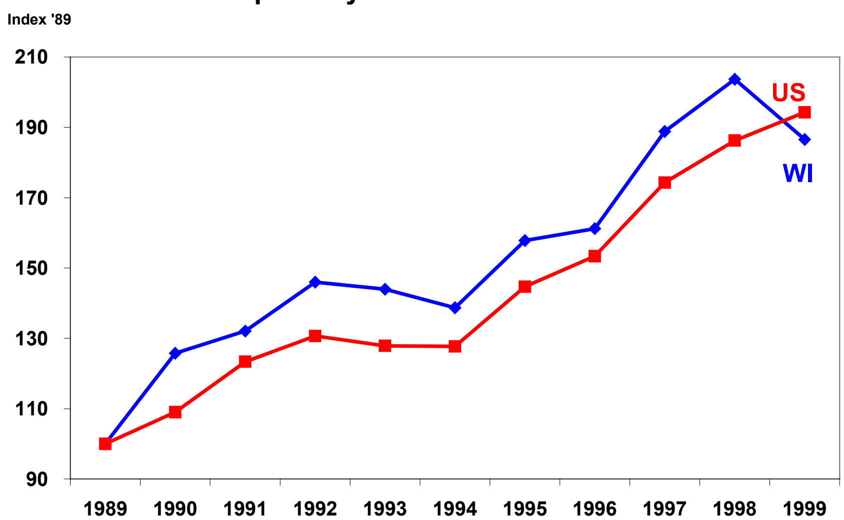


Communications represents an important under performing sector for the Wisconsin economy. Wisconsin has only 60 percent of the economic activity in this sector has the national average. If the state had a just an average amount of activity in this sector, it could have increased GSP by $2 billion or 1.2 percent. Over the last decade, Wisconsin has grown significantly slower than the nation as a whole in this important activity (25 percent less). The state's public utility commission should review the distribution of support activities by the state's major communications providers. It might be that Wisconsin locations have not been chosen by the larger communication providers when choosing to site billing or service centers.   Further consolidation in the industry will make these location decisions important in terms of maintaining job growth in this sector. The state should be aggressive with these public service providers.



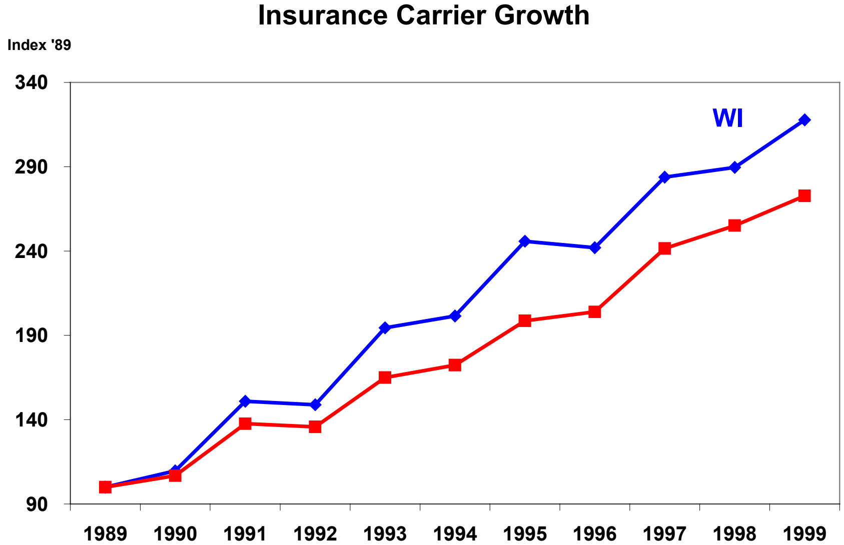
Depository institutions have under performed the national economy. Wisconsin is under represented in this category significantly, and the most recent data shows a significant drop in this activity. This sector represents a large a significant part of the economy with more than $4 billion in economic activity (2.5 percent of GSP). The state should look at its regulatory environment to determine if some legal requirements are making its institutions less competitive than they might be. Recent merger activity has seen many of the top management positions and future growth move out of the state. This is trend that needs to be addressed to prevent future losses.

Depositary Institutional Growth



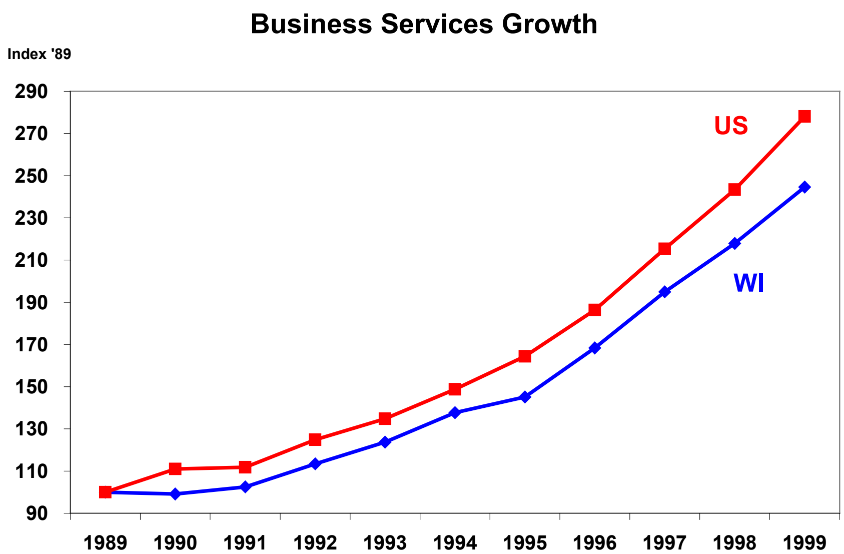
Insurance carriers represent another success story for Wisconsin. They have more than $4 billion in economic activity (2.5 percent of GSP). The state has forty percent more economic activity in this sector than the national average, and it has significantly outgrown the national sector. The consolidation in this sector has worked to Wisconsin advantage with more of the administrative and oversight activity coming into the state from businesses outside of the state. The state needs to make sure that it maintains the right legal structure and oversight to keep the above average performance rolling.

Insurance Carrier Growth



Business services have badly under performed. This last sector remains vital for the state's future economic wellbeing. Business services represent one of the fastest growing elements of the US economy. While many of the manufacturing sectors have grown 50 to 60 percent over the last decade, business services has grown by 180 percent. Business service alone represent more than $6 billion in economic activity (almost 4 percent of the GSP). Unfortunately, Wisconsin only has 70 percent of the national average in this economic activity. If Wisconsin simply had a standard share of business services, it would add more than $3 billion to the state's GSP.

Business services represents an extremely diverse and complex sector. The reasons for Wisconsin's poor performance in this category are equally complex. It is vital that the state look at this sector with particular intensity to avoid losing one of the primary growth engines of the future economy.



Summary

The strategy of nurturing your winners and mitigating your losers might seem overly simplistic. However, the details of each sector are a complex interplay between comparative and competitive advantages. The state can do little to change comparative advantages and disadvantages based on factors such as climate and geography. However, competitive advantages such as efficiency of regulatory oversight and educational systems offer high leverage points for moving ahead.

The strategy of focusing on key sectors with export or import substitution potential helps make better use of the finite resources available to the legislature. Increasing exports or decreasing imports helps many of the state's sectors that depend on local economic wellbeing. These small changes can have large impacts over a number of years making Wisconsin an even better economic competitor.